

IV. GENERAL INFORMATION

A. The Debtor

The Debtor is a Delaware corporation, which, through its predecessor entities, was formed in 1994. The Debtor was originally organized as a Washington limited partnership, which in 1995 merged into a Washington limited liability company. Following several name changes, the Debtor became known as NEXTLINK Communications, L.L.C., a Washington limited liability Company. In January 1997, NEXTLINK Communications, L.L.C. merged into NEXTLINK Communications, Inc., a Washington corporation, which in June 1998 reincorporated in Delaware under the same name. On June 16, 2000, in connection with a merger with Concentric Network Corporation, NEXTLINK Communications, Inc. and Concentric Network Corporation merged into NM Acquisition Corp. and NM Acquisition Corp., as the surviving corporation in the merger, changed its name to NEXTLINK Communications, Inc. On September 25, 2000, XO began doing business as "XO Communications" and, on October 25, 2000, NEXTLINK Communications, Inc. changed its name to XO Communications, Inc. XO's principal executive and administrative offices are located at 11111 Sunset Hills Road, Reston, Virginia 20190, and its telephone number is (703) 547-2000.

XO is primarily a holding company, which owns, manages and controls, directly or indirectly, more than 60 Operating Subsidiaries. The telecommunications services described below are provided primarily by the Company through these Operating Subsidiaries, many of which hold regulatory authorizations and licenses required to provide telecommunication services in the jurisdictions in which they operate.

The Telecommunications Act of 1996 for the first time authorized competition in the local telephone service business. As one of the first companies to enter this market as a competitor to the incumbent telephone companies, the Company began providing high-quality telecommunication services to the business market in 1996. In June 2000, XO expanded its services through a merger with Concentric Network Corporation to include data communication services. As a result, the Company now provides both data and voice communications services to its customers, including local and long-distance telephone services, Internet access, virtual private networks, high-capacity data network services (including dedicated, wavelength and Ethernet services) and website hosting services.

The Company provides its services primarily using network facilities that it owns or controls, which include extensive metropolitan fiber-optic cable and fixed wireless networks in major metropolitan areas and an inter-city fiber-optic network that connects these metro facilities. The Company's networks incorporate state-of-the-art fiber optic cable and transmission equipment and fixed wireless spectrum and related equipment, each of which is capable of carrying high volumes of data, voice, video and Internet traffic. Substantially all of the operating assets of XO consist of its interests in the Operating Subsidiaries, which, in turn, own these network facilities. As of June 30, 2002, the Company operated in over 60 markets in over 20 states and the District of Columbia. The Company currently employs approximately 5,300 people.

B. Directors and Executive Officers of XO

The following table sets forth the names, ages and positions of the XO's Board of Directors. Their respective backgrounds are described following the table.

Name	Position	Age
Daniel F. Akerson	Chief Executive Officer and Chairman of the Board of Directors	53
Nathaniel A. Davis	President, Chief Operating Officer and Director	48
Joseph L. Cole	Director	46
Sandra J. Horbach(1)	Director	41
Nicolas Kauser	Director	62
Craig O. McCaw	Director	52
John H. Myers(2)	Director	56
Sharon L. Nelson	Director	55
Henry R. Nothhaft	Director	58
Jeffrey S. Raikes	Director	44
Peter C. Waal	Director	70
Dennis M. Weibling	Director	51

(1) Elected by holders of the series D preferred stock, held solely by two of the Forstmann Little Partnerships.

(2) Elected by holders of the series C preferred stock, held solely by one of the Forstmann Little Partnerships

Brief biographies of XO's directors are set forth below.

Daniel F. Akerson. Mr. Akerson has served as XO's Chairman of the Board of Directors and Chief Executive Officer since joining XO in September 1999. From March 1996 to February 2001, he was the Chairman of the Board of Directors of Nextel Communications, Inc. From March 1996 to July 1999, he was also Chief Executive Officer of Nextel Communications, Inc. Mr. Akerson currently serves as a director of the American Express Company and AOL Time Warner.

Nathaniel A. Davis. Mr. Davis has served as XO's President and Chief Operating Officer since joining XO in January 2000. In February 2000, he was elected to serve on XO's Board of Directors. From October 1998 to January 2000, Mr. Davis served as Vice President of Technical Services for Nextel Communications. From November 1996 to September 1998, Mr. Davis was Chief Financial Officer of U.S. Operations at MCI. Mr. Davis currently serves as a director of Mutual of America Capital Management Corporation and XM Satellite Radio, Inc.

Joseph L. Cole. Mr. Cole has been a director of XO since February 2000. Since January 1999, he has been Executive Vice President and General Counsel of Ampersand Holdings, Inc., an investment firm. Since October 2000, Mr. Cole also has been Publisher of the Santa Barbara News-Press. From 1984 to 1998, Mr. Cole was a partner of the law firm of Seed, Mackall & Cole LLP, where his practice emphasized corporate law.

Sandra J. Horbach. Ms. Horbach has been a director of XO since January 2000. Since January 1993, she has been a general partner of Forstmann Little. Ms. Horbach currently serves as a director of Community Health Systems, Inc., Citadel Broadcasting Corporation and certain subsidiaries thereof, and Yankee Candle Company, Inc.

Nicolas Kauser. Mr. Kauser has been a director of XO since February 1999. From 1994 to 1998, he was an Executive Vice President and Chief Technology Officer for AT&T Wireless Services.

Craig O. McCaw. Mr. McCaw has been a director of XO since September 1994. From September 1994 to July 1997, he was XO's Chief Executive Officer. Since 1993, Mr. McCaw has been Chairman, Chief Executive Officer and a member of Eagle River. Since 1993, Mr. McCaw has been Chairman and Co-Chief Executive Officer of Teledesic Corporation, a developer of a worldwide satellite-based telecommunications system. Mr. McCaw also currently serves as a director of Nextel Communications.

John H. Myers. Mr. Myers has been a director of XO since October 2001. Since 1997, he has been President and Chief Executive Officer of General Electric Asset Management Incorporated ("GEAM"). From 1986 to 1997, Mr. Myers was Executive Vice President of GEAM. Mr. Myers also serves as a trustee of the General Electric Pension Trust. Mr. Myers serves as a director of GE Capital Services, Inc., Hilton Hotels Corp. and the Pebble Beach Company, a golf management company. Mr. Myers is also a member of the Advisory Committee of Warburg Pincus, an investment advisor, a member of the Pension Managers Advisory Committee of the New York Stock Exchange and a trustee of Wagner College.

Sharon L. Nelson. Ms. Nelson has been director of XO since September 1997. Since September 2000, Ms. Nelson has been the Director of the Center for Law, Commerce and Technology at the University of Washington School of Law. From 1985 to 1997, she was Chairman of the Washington Utilities and Transportation Commission. Ms. Nelson also served on the Federal-State Joint Board on Universal Service created under the Telecommunications Act of 1996 and as one of the 20-member negotiating team appointed by the Governors of Washington, Idaho, Oregon and Montana to review the Northwest electric power system.

Henry R. Nothhaft. Mr. Nothhaft has served as a director of XO since June 2000. Since April 2001, Mr. Nothhaft has served as the Chief Executive Officer of SmartPipes, Inc. From June 2000 to April 2001, he was XO's Vice Chairman. From May 1995 to June 2000, he was President and Chief Executive Officer of Concentric, from August 1995 to June 2000, he served on the Board of Directors of Concentric, and, from January 1998 to June 2000, he served as the Chairman of the Board of Concentric.

Jeffrey S. Raikes. Mr. Raikes has been a director of XO since September 1997. Since July 1996, he has been a member of Microsoft Corporation's Executive Committee and, since January 1996, he has been a Group Vice President of Microsoft.

Peter C. Waal. Mr. Waal has been a director of XO since June 2000. Since 1998, Mr. Waal has been a private telecommunications consultant. From 1986 to 1998, he was Vice President, Strategic Planning and Business Development with DSC Communication Corporation. Mr. Waal currently serves as a director of Info Visa, S. A.

Dennis M. Weibling. Mr. Weibling has been a director of XO since January 1997. From September 1994 to January 1997, he was Executive Vice President of XO. Since January 2002, Mr. Weibling has been Vice Chairman of Eagle River Investments. Since April 2002, he also has been Vice President of One World Challenge, which owns and operates sailing vessels. From 1993 to December 2001, he was President of Eagle River Investments. Mr. Weibling is a member of Eagle River, and he currently serves as a director of Nextel Communications, Nextel International, Inc., and Nextel Partners, Inc.

1. Executive Officers

The following table sets forth the names, ages and positions of XO's executive officers. Their respective backgrounds are described following the table.

Name	Position	Age
Daniel F. Akerson	Chairman, Chief Executive Officer	53
Nathaniel A. Davis	President and Chief Operating Officer	48
Nancy B. Gofus	Executive Vice President, Marketing and Customer Care	48
Michael S. Ruley	Executive Vice President, Market Sales Operations	42
John H. Jacquay	Senior Vice President, National Sales.	49
Gary D. Begeman	Senior Vice President, General Counsel and Secretary	43
Mark W. Faris	Senior Vice President, Network	47

Name	Position Operations	Age
Wayne M. Rehberger	Senior Vice President, Chief Financial Officer	46
R. Gerard Salemmme	Senior Vice President, Regulatory and Legislative Affairs	48

a. Executive Biographies

Brief biographies of XO's officers are set forth below. For biographies of Daniel F. Akerson and Nathaniel A. Davis, see "Director's Biographies" above.

Nancy B. Gofus. Ms. Gofus has served as XO's Executive Vice President, Marketing and Customer Care since September 2000 and was Senior Vice President and Chief Marketing Officer from January 2000 until September 2000. From March 1999 to December 1999, she was the Chief Operating Officer of Concert Management Services, Inc., which previously was a wholly-owned subsidiary of British Telecom and is a global provider of managed telecommunications services. From March 1995 to March 1998, Ms. Gofus was Concert's Senior Vice President of Marketing.

Michael S. Ruley. Mr. Ruley has been Executive Vice President, Market Sales Operations since March 2001. From June 1999 to March 2001, he was XO's President, West Region. From April 1998 to June 1999, he was the President of XO's Southwest Region. From June 1996 to April 1998, Mr. Ruley held various positions at TCG, including Regional Vice President of the Pacific Bell Territory and Vice President and General Manager of both the San Francisco and Colorado markets.

John H. Jacquay. Mr. Jacquay has been XO's Senior Vice President, National Sales since February 2002. From November 1999 to February 2002, he was Chairman and Chief Executive Officer of Pagoo, Inc. From January 1999 to July 1999, Mr. Jacquay was President and Chief Operating Officer of GRIC Communications. From 1997 to 1999, he was Chief Operating Executive -- Regulated Industries unit of MCI Systemhouse. From 1996 to 1997, Mr. Jacquay was President of Network services -- US ONE Communications.

Gary D. Begeman. Mr. Begeman has served as XO's Senior Vice President, General Counsel and Secretary since November 1999. From May 1997 to November 1999, he was Deputy General Counsel of Nextel Communications, and from August 1999 to November 1999, he also was a Vice President of Nextel Communications. From January 1992 to May 1997, Mr. Begeman was a partner of the law firm Jones, Day, Reavis & Pogue, specializing in corporate and securities law and mergers and acquisitions.

Mark W. Faris. Mr. Faris has served as XO's Senior Vice President, Network Operations since April 2001. From September 2000 to April 2001, he was Chief Operating Officer of Gemini Networks. From March 2000 to September 2000, Mr. Faris was President and

Chief Operating Officer of BlueStar Communications. Prior to that, he had been employed by Southwestern Bell for over 20 years.

Wayne M. Rehberger. Mr. Rehberger has served as XO's Senior Vice President, Chief Financial Officer since December 2000. From April 2000 to August 2000, he was Chief Financial Officer of Nettel Communications. On September 28, 2000, Nettel filed a voluntary petition under Chapter 11 of the U.S. Bankruptcy code. From August 2000 to October 2000, Mr. Rehberger was XO's Senior Vice President of Finance. From April 1999 to March 2000, Mr. Rehberger was Senior Vice President of Finance at MCI WorldCom. From June 1986 to March 1999, he held other senior level finance positions at MCI.

R. Gerard Salemm. Mr. Salemm has served as XO's Senior Vice President, Regulatory and Legislative Affairs since January 2000. From March 1998 to January 2000, he served as XO's Senior Vice President, External Affairs and Industry Relations. From July 1997 to March 1998, he was XO's Vice President, External Affairs and Industry Relations. From December 1994 to July 1997, Mr. Salemm was Vice President, Government Affairs at AT&T Corp.

V. EVENTS LEADING TO COMMENCEMENT OF THE CHAPTER 11 CASE

A. Background

Competing effectively with the incumbent local telephone companies has required massive capital expenditures as well as significant investments in marketing efforts and operating expenses by the Company. From 1996, when Federal legislation first was enacted to promote competition in local telecommunications, until 2001, most emerging competitive telecommunications companies, including XO and its predecessors, were generally able to access the capital markets. Since inception, XO has raised billions of dollars in capital, including approximately \$840 million through sales of common stock⁹ and \$1.7 billion through sales of preferred stock. In addition, XO has incurred substantial borrowings, of which approximately \$5.7 billion (including approximately \$557 million of Notes held by a subsidiary of XO) was outstanding as of April 30, 2002.

XO's consolidated debt as of April 30, 2002 included \$1 billion in principal amount of outstanding borrowings under its secured Senior Credit Facility, approximately \$4.2 billion in aggregate principal amount and accreted value of discount notes outstanding under ten issues of Senior Notes (including approximately \$557 million of Notes held by a subsidiary of XO) and \$517.5 million in principal amount outstanding under one issue of Subordinated Notes¹⁰. As of April 30, 2002, XO also had outstanding eight classes of preferred stock¹¹, with an aggregate liquidation preference of approximately \$2.2 billion, approximately \$490 million of which is held by a subsidiary of XO. In addition, as of that date, XO had two classes of common stock, of which the largest holders, on an as converted basis, are Eagle River, Wendy P. McCaw and Forstmann Little & Co. Equity Partnership-VI, L.P.

As of April 30, 2002, XO's unaudited stand-alone books and records reflected total assets of approximately \$8.7¹² billion and total liabilities and long term obligations, including the debt and preferred stock obligations discussed above, of approximately \$8.5 billion. On June 30, 2002, the Company had approximately \$535.9 million in cash and marketable securities on hand (net of outstanding checks). XO wrote-off the entire book value of its goodwill during the quarterly period ended March 31, 2002 as a result of its implementation of recently adopted generally accepted accounting principles.

From inception, XO's business plans had always assumed that as long as it continued to demonstrate success in penetrating and operating profitably in its established markets, it would be able to access the capital markets to fund its operating expenses and

⁹ Excludes proceeds from the sale of common stock through employee plans.

¹⁰ For a complete list of the issuances of Senior Notes and Subordinated Notes, see "VIII Capitalization - C. Outstanding Notes".

¹¹ For a complete list of the issuances of this outstanding preferred stock, see "VIII Capitalization - B. Outstanding Old Preferred Stock.

¹² Approximately \$8.2 billion of these assets represent intercompany investments and receivables.

network construction costs until such time as the cash generated from operations would be sufficient to cover its total cash requirements. Until 2001, the Company's ability to raise capital had always validated this assumption.

In 2001, although the capital markets were becoming increasingly reluctant to finance many emerging telecommunications companies, including a number of the Company's competitors, XO continued to be able to raise investment capital. In January 2001, XO issued \$517.5 million in 5-3/4% Convertible Subordinated Notes due 2009. In June 2001, XO raised \$250 million in a private placement of common stock with one of the Forstmann Little Partnerships. As discussed further below, the Forstmann Little Partnerships had previously invested \$1.25 billion in XO convertible preferred stock.

Despite these financings, the Company recognized the changes taking place in the capital markets for telecommunications companies generally and took aggressive steps, beginning in the first half of 2001 and continuing through the remainder of the year, to significantly scale back its business plans and conserve available cash resources. These measures included (i) canceling plans for expansion in Europe, (ii) curtailing domestic expansion plans into new markets, (iii) reducing headcount from approximately 7,400 employees at the end of fiscal year 2000 to the Company's current workforce of approximately 5,300, (iv) outsourcing network capacity through a strategic agreement with Level 3 Communications, Inc. ("Level 3") and (v) centralizing customer care and network service operations. Despite these efforts, the Company needs a significant cash infusion to fund the operating expenses, capital expenditures and debt service necessary to bring its operations to cash-flow breakeven on a Company-wide basis.

Following a June 2001 equity investment by one of the Forstmann Little Partnerships, the Company continued to discuss its future capital needs with representatives of both Eagle River and Forstmann Little. The Company concluded at that time that deleveraging its balance sheet might put it in a position to obtain the additional capital required to fund the Company's business to break-even cash flows. The Company also consulted with numerous investment banks regarding the Company's prospects for obtaining the additional capital required to fund the Company's business to break-even cash flows. These investment banks generally agreed that the Company would be unable to secure additional equity financing at that time unless it significantly deleveraged its balance sheet. At June 30, 2001, the Company had approximately \$1.37 billion of cash and marketable securities, while at that same time, its senior notes and junior obligations were trading at substantial discounts to their face amounts. Thus, with a view to facilitating future equity investments and upon the advice of the investment banks, the Company repurchased Notes with a face amount and accreted value of approximately \$557 million and Old Preferred Stock with a liquidation preference of approximately \$490 million (which repurchases did not include any of the Old Preferred Stock held by the Forstmann Little Partnerships) for \$290 million primarily in the third quarter of 2001.

During the third and fourth quarters of 2001, the Company engaged in discussions with Forstmann Little, Eagle River and several other prospective investors regarding possible investment and restructuring opportunities. Substantial due diligence activities by the potential investors ensued, including discussions with the Company's senior management, review of the Company's operating strategies and review of the Company's business plan and other

confidential financial information. The Company also consulted with numerous investment banks regarding the Company's prospects for obtaining the additional capital required to fund the Company's business to breakeven cash flows. These investment banks generally agreed that the Company would be unable to secure additional equity financing at that time unless it significantly deleveraged its balance sheet.

Conditions in the telecommunications capital markets continued to deteriorate and, in the latter part of 2001, those markets were closed entirely for all practical purposes. In the third and fourth quarters of 2001, the market valuations of the debt and equity securities of telecommunications companies, especially emerging providers such as the Company, experienced catastrophic declines, leading to a wave of bankruptcies throughout the industry. The capital markets began to focus more attention on the degree to which each telecommunications company was leveraged, irrespective of the amount of cash each telecommunications company had available. At the same time, several telecommunications providers had recently filed or were believed to be about to file for bankruptcy protection, and resulting increased customer concerns regarding the stability and sustainability of their telecommunications provider required that the Company obtain additional capital to deleverage its balance sheet and address the concerns of its customers.

B. Development of the Restructuring

It became clear to the Company in the fourth quarter of 2001 that obtaining additional capital that the Company required to fund operations until it was expected to achieve positive cash flow would require a much more significant balance sheet restructuring than had previously been contemplated. In October 2001, XO retained Houlihan Lokey as its outside financial advisor to assist it in exploring a variety of deleveraging alternatives, including both a stand-alone restructuring and third-party investment scenarios, both in and out of bankruptcy. The Company then concluded, based on its estimates regarding future operating results under a business plan that assumed both continued significant growth and the continued payment of interest on the Senior Credit Facility, that it would require a minimum of \$500 million of new capital to be reasonably assured of reaching a cash flow breakeven point without having to raise other additional funding, even assuming a successful balance sheet restructuring that eliminated all cash interest and preferred dividend payments on XO's Notes and Old Preferred Stock.

During the second half of 2001, the Company continued to revise its business plans and projections in light of the deteriorating conditions in the telecommunications sector and general economic conditions, including the impact from the events of September 11, 2001 amid input from prospective investors. Extensive analysis and consultations with Houlihan Lokey confirmed the fact that additional capital would likely not be available without a significant restructuring of the Company's capitalization.

At the Company's request, Houlihan Lokey prepared solicitation materials and, beginning in November 2001, contacted over fifty potential investors, both strategic and financial, in an effort to raise the required new capital, and actively engaged in discussions with Forstmann Little, Eagle River and other potential investors concerning the Company's business plans and a potential equity investment. Houlihan Lokey approached potential third-party investors that had previously or currently had investments in the telecommunications industry

and/or had the financial wherewithal to make a minimum \$500 million investment in the Company on their own or in connection with one or more financial partners. At this time, Forstmann Little and Eagle River continued their due diligence activities that had begun in the third quarter of 2001.

C. Discussions with Forstmann Little and Telmex

On November 21, 2001, Forstmann Little, on behalf of the Forstmann Little Investors, submitted a draft term sheet that proposed a \$700 million equity investment in the Company by the Forstmann Little Investors and a then-unnamed third-party investor (later identified as Telmex), conditioned on, among other things, a substantially deleveraged balance sheet. The terms of the proposal contemplated the elimination of all or substantially all of XO's outstanding equity, including the common and preferred stock that the Forstmann Partnerships had purchased for a total of \$1.5 billion, and offered 16% of Reorganized XO's equity to unsecured noteholders, along with \$100 million in cash. Proceeds from the Investment were to be used to fund the continued development of the Company's broadband telecommunications network, ongoing business operations and payments under the contemplated deleveraging process.

Because of the Forstmann Little Partnerships' board representation, and the possibility that Eagle River might participate in a financing proposal, the Board of Directors formed a subcommittee of non-management directors unaffiliated with either Forstmann Little or Eagle River to evaluate the merits of the Forstmann Little proposal in consultation with Houlihan Lokey and the Company's legal advisors. While Houlihan Lokey continued its search for alternative investors, XO and its financial and legal advisors, under the supervision of this subcommittee, engaged in extensive discussions and negotiations with the Forstmann Little Investors with respect to all the terms of their proposed investment, and obtained agreement to substantial improvements to those terms. As a result of these negotiations, among other things, the total amount to be invested increased to \$800 million, the equity percentage in Reorganized XO allocable to unsecured noteholders increased from 16% to 18% and the proposed restructuring included \$200 million in cash (increased from \$100 million in the original proposal) available to be paid to unsecured noteholders. In addition, the amount of the break-up payment was reduced, and the break-up payment provisions made applicable only upon the execution of a definitive agreement relating to an alternative transaction.

On November 28, 2001, XO entered into a non-binding term sheet with the Investors providing for an \$800 million investment in XO and the next morning announced publicly all the material terms and conditions of the proposed investment. Telmex, the leading telecommunications company in Mexico, is not affiliated with XO, the Forstmann Little Partnerships or the Forstmann Little Investors. Also on November 28, 2001, the Forstmann Little Investors, Telmex and Eagle River informed XO that the Forstmann Little Investors and Telmex had reached a preliminary understanding with Eagle River under which Eagle River would be given an opportunity to participate in a portion of the \$800 million investment contemplated under the Term Sheet.

From November 28, 2001 to January 15, 2002, XO engaged in extensive negotiations regarding the terms and conditions of the Investment Agreement with the Forstmann

Little Investors and Eagle River. In the meantime, Houlihan Lokey continued to attempt to identify other potential strategic and financial investors, including other third parties who became aware of the situation through publicly available information regarding the terms of the Investors' proposed investment, in an effort to procure a competing proposal prior to the execution of the Investment Agreement. During this time, although several prospective alternative investors conducted preliminary due diligence with the Company, no preliminary indications of interest or proposals were received. On January 14, 2002, Eagle River informed XO that it would not be participating in the investment by the Investors. On January 15, 2002, after extensive additional discussion and negotiation with the Forstmann Little Investors and Telmex, and having received no investment proposals from any other prospective investor, XO executed the Investment Agreement and announced the execution of the Investment Agreement the following day. Notwithstanding the foregoing, Houlihan Lokey continued to hold discussions with potential alternative sources of capital after the execution of the Investment Agreement.

D. Discussions with the Holders of Notes

1. Senior Note Committee

a. Restructuring Proposal by the Investors

Concurrently with the discussions and negotiations with the Investors, certain Holders of Senior Notes formed the Senior Note Committee to discuss the terms of the proposed restructuring with XO and the Investors, and the Senior Note Committee retained Akin, Gump, Strauss, Hauer & Feld as its legal counsel and Jefferies & Company, Inc. as its financial advisor. From January 2002 through March 2002, XO and the Investors held discussions with representatives of the Senior Note Committee, its legal counsel and financial advisors in an effort to develop the terms of a restructuring proposal that would be acceptable to the Investors and members of the Senior Note Committee.

During the course of these discussions and negotiations, the Investors proposed, among other things, to increase their investment from \$400 million each to \$410 million each, or a total of \$820 million, in order to fund an increased cash payment of \$220 million (compared to the \$200 million contemplated by the Investment Agreement) to the Holders of Senior Notes, and that the Company issue to the Holders of Senior Notes new warrants to purchase New Class A Common Stock. Under this revised proposal, the outstanding common stock remaining after the Investment (other than that portion allocated to XO's management), approximately 18% of the outstanding common equity of Reorganized XO, new warrants representing an additional 4% of the outstanding common equity of Reorganized XO and the \$220 million in cash would have been allocated pro rata to Holders of Allowed Senior Note Claims. On March 8, 2002, the Senior Note Committee rejected these proposals by the Investors.

b. Restructuring Proposal by the Senior Note Committee

On March 8, 2002, in connection with the rejection by the Senior Note Committee of the Investors' most recent proposal, XO received a preliminary restructuring proposal made by certain Holders of its Senior Notes regarding the terms of a potential financing and

restructuring (the "Senior Noteholder Proposal") that was intended to replace the Investment and related transactions provided for in the Investment Agreement.

The Senior Noteholder Proposal contemplated a pre-negotiated bankruptcy, in which the Holders of Senior Notes and Senior Secured Lenders would be offered the right to subscribe to a fully committed \$500 million rights offering. In exchange for the \$500 million, the subscribing investors would receive, among other things, (a) \$300 million in 10% super priority secured notes due 2009; (b) seven year warrants to purchase 10% of the fully-diluted common stock of the Company at an exercise price equal to the \$600 million implied equity value of the Senior Noteholder Proposal and (c) \$433.9 million principal amount in 8% convertible subordinated discount notes due 2012 (initial accreted value of \$200 million) convertible into 28.3% of the fully diluted common shares of XO. In addition, 55% of the fully diluted common shares of XO would be distributed, pro rata, to the Holders of Senior Notes.

Certain members of the Senior Note Committee along with other parties offered to commit to underwrite the \$500 million Senior Noteholder Proposal. As consideration for this commitment, these parties would receive seven year warrants to purchase 5% of the fully-diluted common stock of the Company at an exercise price equal to the \$600 million implied equity value of the Senior Noteholder Proposal.

XO's management carefully reviewed the Senior Noteholder Proposal, and its advisors analyzed it and presented their advice both to XO's management and to XO's Board of Directors. Based on their advice, XO concluded that the Senior Noteholder Proposal would not represent a feasible alternative for the successful restructuring of XO. Specifically, XO noted that the Senior Noteholder Proposal would not result in XO being fully funded (with an adequate cash reserve) based on its estimated future requirements based on its business plan that assumed both significant growth and the continued payment of interest on the Senior Credit Facility and did not have, and was unlikely to win the support of the Holders of Senior Secured Lender Claims both as to the overall restructuring plan and with respect to expected modifications to the Senior Credit Facility. Based on this assessment, on March 11, 2002, XO rejected the debt financing proposal of the Senior Note Committee.

c. Restructuring Proposal by the Icahn Group

On March 22, 2002, the Icahn Group and the Senior Note Committee submitted a draft term sheet to the Company contemplating a \$500 million equity investment in the Company for an indirect 50% equity ownership interest in the Company as an alternative to the transaction contemplated by the Investment Agreement. XO's Board of Directors, with the assistance of its financial and legal advisors, carefully reviewed this proposal and concluded that it represented an inferior proposal to the Investment Agreement. Concurrently, Forstmann Little informed XO that it would not increase the consideration provided in the Investment Agreement in response to proposals by the Icahn Group. On March 27, 2002, XO delivered a letter to the Icahn Group and the Senior Note Committee containing the terms and conditions necessary before a proposal could be viewed as superior to the Investment contemplated by the Investment Agreement.

On April 1, 2002, the Icahn Group submitted the Icahn Proposal contemplating a corporate reorganization, described below, and the purchase by the Icahn Group of a 55%

ownership interest in the business and assets currently operated by the Company for \$550 million in cash. The Icahn Group advised XO that the Icahn Proposal had the support of, among others, the Senior Note Committee.

As part of the consideration for this transaction contemplated by the Icahn Proposal, the Company would have been required to engage in a corporate reorganization in which a limited liability company subsidiary ("XO Holdings") would be required to serve as an intermediate holding company holding interests in newly created limited liability company subsidiaries that would, following the corporate reorganization, conduct substantially all of the Company's business and hold substantially all of its operating assets.

Under the plan of reorganization contemplated by the Icahn Proposal, XO's equity and subordinated debt would have been cancelled, and senior noteholders and holders of certain other claims against XO would receive common equity interests in Reorganized XO. As part of the plan of reorganization, the Icahn Group would have purchased, and the Senior Notes held by the Icahn Group would have been converted into, a separate class of common stock initially having 49% of the voting power in Reorganized XO, and the Icahn Group would initially nominate a majority of the members of the Company's Board of Directors.

The \$550 million investment provided for in the Icahn Proposal would have been implemented by the Icahn Group's purchase of 50% of XO Holdings' common equity for \$500 million, leaving Reorganized XO as the owner of the remaining 50% common equity interest in XO Holdings, and the purchase by the Icahn Group of 10% of the common stock of Reorganized XO (representing an indirect interest in 5% of XO Holdings' equity) from the Company for \$50 million. The plan of reorganization contemplated by the Icahn Proposal would also have provided for the establishment of a stock option plan covering 14% of reorganized XO's common stock (representing an indirect interest in 7% of the common equity of XO Holdings.) After the restructuring, holders of equity in Reorganized XO would have certain tag-along rights and other protections for minority holders for three and a half years.

The investment and corporate reorganization transactions contemplated by the Icahn Proposal would have been contingent upon the approval of the Senior Secured Lenders, including their consent to longer maturities and extension of prepayment dates, as well as significant modifications to their rights, including changes in a number of financial and operational covenants.

Throughout April and into May 2002, XO, the Icahn Group and the Senior Note Committee prepared the documentation necessary for, and engaged in the negotiation with XO as to, the investment and corporate reorganization transactions contemplated by the Icahn Proposal. Concurrently with these negotiations, XO and the Icahn Group engaged in negotiations with the Senior Lenders Committee to amend the Senior Credit Facility in a manner that would permit and facilitate the investment contemplated by the Icahn Proposal. In early May 2002, these negotiations ended without an agreement. Subsequently, the Icahn Group delivered a letter to the Senior Lenders Committee stating that they would attempt to block and contest any other transaction.

On July 10, 2002, High River Limited Partnership, an Delaware limited partnership controlled by Mr. Icahn, announced an offer to purchase up to an aggregate of \$331 million in principal amount of the loans outstanding under the Senior Credit Facility (the "Senior Secured Loans") at a purchase price of \$0.40 per \$1.00 in principal amount of the Senior Secured Loans (the "Icahn Purchase Offer"). According to the announcement in the New York Times on July 10, 2002, the Icahn Purchase Offer will be conducted on a "first-come first-served" basis and, if on or prior to July 17, 2002, the Requisite Lenders (as defined in the Senior Credit Facility) rescind the June 11, 2002 amendment to the Senior Credit Facility, the Icahn Purchase Offer will be deemed to be made for any and all of the Senior Secured Loans. According to the Icahn Purchase Offer, it may be amended or modified at any time by High River Limited Partnership.

d. Stand-Alone Plan

On July 18, 2002, the Official Committee of Unsecured Creditors reached an agreement with a subgroup of the Senior Lenders Committee on the terms and conditions of the Stand-Alone Plan. On July 19, 2002, the Official Committee of Unsecured Creditors informed the Bankruptcy Court that they would support both the FL/Telmex Plan and the Stand-Alone Plan.

2. Subordinated Noteholder Committee

Concurrently with the discussions and negotiations with the Senior Secured Lenders and the Senior Note Committee, certain Holders of the Subordinated Notes formed an informal committee (the "Subordinated Noteholder Committee") to discuss the terms of the proposed restructuring with XO. Although representatives of XO met with representatives of the Subordinated Noteholder Committee, as of the Petition Date no agreement has been reached with the Subordinated Noteholder Committee.

E. Discussions with Senior Secured Lenders

1. Development of the Agreement with the Senior Secured Lenders

Concurrently with the negotiation of the terms of the Investment Agreement, XO contacted the Senior Secured Lenders under its \$1 billion Senior Credit Facility, who had formed the Senior Lenders Committee. In January and February of 2002, Forstmann Little and Telmex engaged in extensive negotiations with the Senior Lenders Committee relating to the Amended and Restated Senior Credit Facility. The Investors requested substantial concessions from the Senior Lenders Committee in connection with the transactions contemplated by the Investment Agreement. These negotiations resulted in the Bank Amendment Term Sheet included as Exhibit B to the Bank Plan Support Agreement, attached hereto as Appendix E. Subsequently, at the request of the Investors, counsel for the Senior Lenders Committee distributed to the Holders of Senior Secured Lenders Claims a lock-up agreement supporting the transactions contemplated by the Investment Agreement, in a form approved by the Investors, together with the Bank Amendment Term Sheet and a request that those Holders execute the lock-up agreement. As of March 2002, Holders of more than two-thirds of the Senior Secured Lender Claims had executed

a lock-up agreement. However, these lock-up agreements were never executed by the Investors or the Company and have been superseded by the Bank Plan Support Agreement.

Later, in April 2002, this Senior Lenders Committee engaged in extensive discussions and negotiations with XO and the Icahn Group to amend the Senior Credit Facility in a manner that would permit and facilitate the transactions contemplated by the Icahn Proposal. However, in early May 2002, (as discussed above) the negotiations ended without an agreement.

2. The Stand-Alone Term Sheet Proposal by Senior Lenders

Subsequently, and in light of the uncertainty as to whether the conditions in the Investment Agreement would be met, the Senior Lenders Committee asked XO to prepare a modified business plan contemplating a stand-alone investment that assumed no receipt of additional third-party equity capital. While management of XO revised its business plan to reflect a stand-alone restructuring with no third-party equity capital, representatives for the Senior Lenders Committee conducted due diligence and Houlihan Lokey continued to search for other potential investors. In late May 2002, XO and the Senior Lenders Committee held discussions on a standalone restructuring plan under which \$500 million in principal amount (plus accrued interest) of senior secured loans would be converted into all of the equity of Reorganized XO, subject to dilution from their gifts of a \$200 million rights offering to junior security holders, New Warrants to be distributed to Holders of Senior Notes and General Unsecured Claims in certain events and New Options to be granted to management and other employees. The remaining \$500 million of senior secured loans would be converted into \$500 million in principal amount of Junior Secured Loans with cash interest required to be paid by Reorganized XO only if Reorganized XO achieves specified financial targets. To the extent the Rights Offering raised less than \$200 million, a senior secured Exit Facility of up to \$200 million was also contemplated.

Recognizing both the superior financial terms of the transactions contemplated by the Investment Agreement and the uncertainty engendered by conditions thereto, the Company concluded that the most appropriate course of action would be to advance a plan of reorganization contemplating the consummation of the transactions contemplated by the Investment Agreement, and also contemplating the restructuring contemplated by the Stand-Alone Term Sheet if the Investment Agreement were to be terminated or if XO were to conclude, after discussion with the Administrative Agent, that the Investors will not comply with their obligations to close under the Investment Agreement upon satisfaction of the applicable conditions thereunder. In furtherance of the Plan, on May 24, 2002, the Senior Lenders Committee circulated Bank Plan Support Agreements to the senior secured lenders providing for them to support the transactions contemplated by the Investment Agreement, with a view to delivering them to the Company on May 31.

On May 31, 2002, however, the Senior Lenders Committee informed XO that the Bank Plan Support Agreement had not been executed due to a request by Forstmann Little that XO delay its anticipated chapter 11 bankruptcy filing for a seven to ten day period to permit another round of due diligence on the part of Forstmann Little and discussions between the Senior Lenders Committee and Forstmann Little with respect to a less conditional investment transaction at a lower valuation.

On June 6, 2002, the Investors informed XO and the Senior Lenders Committee that it would not submit a revised proposal, and later that evening counsel for the Investors delivered a letter addressed to counsel for XO stating that they considered it "virtually impossible" that the conditions to the Investment Agreement would ever be satisfied and asking the Company to release the Investors from their obligations under the Investment Agreement. On June 7, 2002, XO replied that it had made substantial progress in satisfying the conditions to the Investment Agreement. XO advised the Investors that, under the circumstances, XO saw no reason to believe that the closing conditions could not be satisfied, did not believe the Investors had any right to terminate their obligations unilaterally, and was not in a position to release the Investors from their obligations under the Investment Agreement without substantial consideration. Subsequently, the Investors have reiterated their belief that the conditions to closing the Investment Agreement will be "virtually impossible" to satisfy.

On June 11, 2002, XO and holders of a majority of the Senior Secured Loans under the Senior Credit Facility executed an amendment to the Senior Credit Facility, which requires the written consent of the Requisite Lenders (as defined in the Senior Credit Facility) to sell, assign, transfer or participate in the Senior Secured Loans until the earlier of September 15, 2002 and the date the amendment is rescinded by the Requisite Lenders.

On June 13, 2002, holders of a majority of Senior Secured Loans under the Senior Credit Facility delivered Bank Plan Support Agreements to XO binding them to vote to accept a plan that provides them with the treatment agreed to the Bank Amendment Term Sheet. Also on June 13, 2002, XO received a letter from Toronto Dominion (USA), Inc. on behalf of Toronto Dominion (Texas), Inc. the Administrative Agent confirming the Senior Lenders Committee's willingness to support the transactions contemplated by a draft stand-alone term sheet if the Investment Agreement does not close for any reason.

On July 16, 2002, XO received a letter from the Administrative Agent confirming the Senior Lenders Committee's willingness to support the transactions contemplated by the Stand-Alone Term Sheet if the Investment Agreement does not close for any reason, attached hereto as Appendix F.

On July 18, 2002, a subgroup of the Senior Lenders Committee reached an agreement with the Official Committee of Unsecured Creditors on the terms and conditions of the Stand-Alone Plan.

3. Bank Plan Support Agreement

The following description summarizes the terms of the Bank Plan Support Agreement and does not modify the Bank Plan Support Agreement. In all instances of ambiguity or inconsistency, the Bank Plan Support Agreement controls.

On June 13, 2002, Senior Secured Lenders holding \$584,990,000 in aggregate principal amount of the Senior Credit Facility (approximately 58% of Class 1 Claims) executed the Bank Plan Support Agreement with XO and XO Management (as defined below) requiring such Senior Secured Lenders, subject to certain conditions, to vote in favor of a plan implementing the terms of the Investment Agreement.

a. Acceptance of the Restructuring

Pursuant to the terms of the Bank Plan Support Agreement, so long as the Bank Plan Support Agreement is in effect, each of the Senior Secured Lenders that are parties thereto (each a "Consenting Participant"):

- i. accepts the terms and conditions of the Restructuring (as such term is defined in the Bank Plan Support Agreement) and agrees to vote to accept any plan of reorganization, whether on a prepackaged or prearranged basis, that incorporates the terms and conditions of the Restructuring (as such term is defined in the Bank Plan Support Agreement), the Bank Amendment Term Sheet and the Investment Agreement, pursuant to Section 1126 of the Bankruptcy Code.
- ii. agree that, as long as the Bank Plan Support Agreement and the Investment Agreement both remain in effect, and subject to (iii) below, such Consenting Participant will not (A) object to, delay, impede or take any other action to prevent the acceptance, confirmation or implementation of the Plan or otherwise commence any proceeding to oppose or alter the Plan or all documents implementing the Plan (the "Plan Documents") to the extent the Plan and the Plan Documents are not inconsistent with the terms and conditions set forth in the Bank Amendment Term Sheet; (B) exercise any of its remedies against any subsidiary of XO that is not a party to the Chapter 11 Case ; (C) vote for, consent to, support, encourage or participate, directly or indirectly, in the formulation of any other plan of reorganization or liquidation proposed or filed or to be proposed or filed in the Chapter 11 Case; (D) directly or indirectly seek, solicit, support, vote for, consent to or encourage any other plan, sale, proposal or offer of dissolution, winding up, liquidation, reorganization, merger or restructuring of XO or any of its subsidiaries that could reasonably be expected to prevent, delay or impede the successful restructuring of XO as contemplated by the Plan or the Plan Documents; (E) object to, delay, impede or take any other action to prevent approval of, the disclosure statement or the solicitation of consents to the Plan; or (F) take any other action that is inconsistent with the Plan or the Plan Documents, or that would delay confirmation of, the Plan.
- iii. agree that nothing contained in the Bank Plan Support Agreement shall be construed to prohibit any party thereto from developing or negotiating one or more plans of reorganization intended to serve as contingency plans in the event (and only in the event) that the Investment Agreement is terminated in accordance with its terms or otherwise not consummated, or from including such a

contingency plan in the Plan and Disclosure Statement on that basis.

b. Agreement to make Adequate Protection Payments to Senior Secured Lenders.

As consideration for the Bank Plan Support Agreement, XO Management Services, Inc. ("XO Management"), a guarantor under the Senior Credit Facility, has agreed to pay the fees and expenses of the Professionals for the Administrative Agent during the pendency of the Bankruptcy Case, and upon consummation of the transactions contemplated by the Investment Agreement to make payment in cash to the Senior Secured Lenders of all accrued and unpaid interest that would have been due to the Senior Secured Lenders under the Senior Credit Facility notwithstanding the commencement of the Chapter 11 Case.

c. Termination.

The Bank Plan Support Agreement may be terminated by any party thereto (except as expressly provided therein) by delivery of a written notice to each of the other parties thereto and the Administrative Agent upon the occurrence of any of the following events, provided, however, that such delivery of such written notice by any Consenting Participant shall terminate the Bank Plan Support Agreement only with respect to such Consenting Participant and not with respect to any other Consenting Participant or XO:

- (i) XO has failed to commence its Chapter 11 Case on or before the tenth (10th) business day following the date on which all of the conditions set forth in Section 1 of the Bank Plan Support Agreement have been satisfied or waived by the parties thereto;
- (ii) XO has failed to file the Plan and Disclosure Statement, each in a form reasonably acceptable to the Administrative Agent, on or before the second (2nd) business day following the Petition Date;
- (ii) the Disclosure Statement has not been approved by the Bankruptcy Court on or before the seventy-fifth (75th) day following the Petition Date;
- (iii) the Plan has not been confirmed by the Bankruptcy Court on or before the one hundred and twentieth (120th) day following the Petition Date;
- (iv) the Plan has not been consummated by the date on which either Investor has the right, under Section 6.1(b) of the Investment Agreement, to terminate its own rights and obligations under the Investment Agreement;
- (v) solely with respect to a termination by any Consenting Participant, and subject to Section 2(c) of the Bank Plan Support Agreement, XO takes any action inconsistent with (a) the Bank Plan Support Agreement, (b) effectuating the Restructuring (as defined in the Bank Plan Support Agreement), (c) seeking prompt confirmation of the Plan, or (d) consummating the Investment under the Investment Agreement, in any

case only if such action is materially detrimental with respect to such Consenting Participant as a Lender, or (e) the Bank Amendment Term Sheet;

- (vi) solely with respect to a termination by any Consenting Participant, XO does not stay in compliance with the Budget (as defined in the Bank Plan Support Agreement) ;
- (vii) solely with respect to a termination by any Consenting Participant, Consenting Participants holding at least a majority of principal amounts of claims held by the Consenting Participants then holding a claim have agreed in writing to terminate the Bank Plan Support Agreement;
- (viii) XO, and subject to Section 2(c) of the Bank Plan Support Agreement, the Consenting Participants take any action materially inconsistent with (a) the Bank Plan Support Agreement, (b) effectuating the Restructuring (as defined in the Bank Plan Support Agreement), (c) seeking prompt confirmation of the Plan, or (d) consummating the Investment under the Investment Agreement; or
- (vii) the Investment Agreement is (a) terminated in accordance with its terms or by order of court or (b) amended or modified in any manner inconsistent with the terms of the Bank Plan Support Agreement.

4. Amended and Restated Senior Credit Facility

The following description summarizes the Bank Amendment Term Sheet attached as Exhibit A to the Bank Plan Support Agreement (the "Bank Amendment Term Sheet"). In all instances of ambiguity or inconsistency, the Bank Amendment Term Sheet controls.

Some of the principal proposed amendments to the Senior Credit Facility as set forth in the Bank Amendment Term Sheet include the following:

- a. the maturity and repayment dates of the loans have been extended for three years;
- b. minimum cash balance, minimum EBITDA and maximum capital expenditure covenants have been added, while the consolidated total debt to annualized consolidated EBITDA and consolidated EBITDA to consolidated cash interest expense covenants have been revised to become effective on later dates and with different ratios; all other financial covenants have been eliminated;
- c. the amount of permitted pari passu borrowing from third parties under any future incremental term loan facility has been reduced from \$1.0 billion to \$250 million, subject to further reduction under certain circumstances;
- d. other Permitted Indebtedness, Permitted Equipment Financing, Acquired Debt and Capital Leases (as such terms are defined in the Senior Credit Facility) are limited to

\$500 million, in the aggregate, subject to reduction by amounts utilized by the incremental facility and designated net asset sale proceeds of up to \$250 million;

e. proceeds from net asset sales remain subject to reinvestment within 270 days and must be reinvested in hard assets that become collateral, provided, that under the Amended and Restated Senior Credit Facility no more than \$25 million of net asset sale proceeds may be outstanding pending such reinvestment at any given time, provided, that a designated amount of additional net asset sale proceeds, not in excess of \$250 million in the aggregate, may be subject to the reinvestment option, but such amount shall offset the amount otherwise available under the basket of additional indebtedness described in (d) above;

f. there are new limitations with respect to Restricted Payments, Permitted Acquisitions, Investments and Joint Ventures (as such terms are defined in the Senior Credit Facility);

g. the revolving credit facility (which is fully drawn) will be converted into a term loan facility;

h. a mandatory prepayment will be triggered if any third party other than the Forstmann Little Investors or Telmex owns more than 50% of XO's voting stock;

i. there are additional covenants with respect to financial reporting;

j. the full amount of the credit facilities will be guaranteed by all wholly-owned domestic subsidiaries;

k. the credit facilities will be secured by substantially all the assets of XO and the guarantors; and

l. all prepayments under the Amended and Restated Senior Credit Facility will be applied pro rata across all the term facilities then outstanding thereunder.

Many of the maturity dates, repayment dates and other dates with respect to financial covenants will be further extended if the closing of the Investment is delayed beyond June 30, 2002.

F. The Restructuring

The Debtor has developed the Plan and this related Disclosure Statement, the former of which is being filed with the Bankruptcy Court contemporaneously herewith with the input and support of the Senior Lenders Committee. The Plan provides for the implementation of either the FL/Telmex Plan or the Stand-Alone Plan in the event the FL/Telmex Plan is not consummated. Under the FL/Telmex Plan, the Debtor will be reorganized through the consummation of the Investment Agreement with the Investors. In the event (a) the Investment Agreement is terminated by the Investors or XO or (b) XO, after discussions with the Administrative Agent (either because one or more conditions to the Investors' obligations have been satisfied in full or otherwise), concludes that the Investors will not consummate the transactions contemplated by the Investment Agreement and delivers the Stand-Alone Notice to